UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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IN RE: AMERICAN EXPRESS CO. SECURITIES LITIGATION

02 Civ. 5533 (WHP)

MEMORANDUM AND ORDER

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WILLIAM H. PAULEY III, District Judge:

This consolidated class action combines twelve suits alleging securities fraud by American Express Company ("Amex" or the "Company") and several of its officers - Harvey Golub, Kenneth I. Chenault, Richard Karl Goeltz, Gary L. Crittenden, Daniel T. Henry, David R. Hubers and James M. Cracchiolo (the "Individual Defendants").[1] Plaintiffs are purchasers of Amex common stock between July 26, 1999 and July 17, 2001 (the "class period"). The Consolidated Amended Class Action Complaint (the "Amended Complaint" or "Amended Compl.") alleges violations of section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b) (2000), and SEC Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (2000). Plaintiffs also assert a "control person" claim against the

[1] Harvey Golub was Amex's Chairman, CEO and a director until his resignation in 2000; Chenault was Amex's President, COO and a director until his appointment as CEO in January 2001; Goeltz was the Company's Vice Chairman and CFO until his resignation in June 2000; Crittenden has served as CFO and Executive Vice President since June 2000; Henry is the Company's Senior Vice President and Comptroller; Hubers is President of Amex's subsidiary, American Express Financial Advisors ("AEFA"); and Cracchiolo is the CEO and Chairman of AEFA. (Compl. ¶¶ 26a-26g.)

Individual Defendants under Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a) (2000). Defendants move to dismiss the Amended Complaint pursuant to Rules 12(b)(6) and 9(b) of the Federal Rules of Civil Procedure, and Sections 21D and 21E of the Exchange Act, 15 U.S.C. §§ 78u-4, 78u-5 (2000). For the following reasons, defendants' motion is granted.

BACKGROUND

Amex is a publicly traded financial services corporation. (Amended Compl. ¶ 40.) Through its subsidiary, American Express Financial Advisors ("AEFA"), Amex provides a variety of financial products including insurance and annuities. (Amended Compl. ¶¶ 40-41.) IDS Life Insurance Company ("IDS"), an AEFA subsidiary, sells insurance products and invests the premiums on its own account in fixed income securities with a broad range of maturities. (Amended Compl. ¶ 41.) The returns generated from these investments are used to pay benefits under those insurance policies. (Amended Compl. ¶ 41.) According to plaintiffs, a direct correlation exists between the return on AEFA's investments and the premiums charged to the holders of IDS insurance policies: the higher the return, the lower the premium. (Amended Compl. ¶ 41.)

Plaintiffs allege that, beginning in 1997 Golub set aggressive earnings targets for Amex. (Amended Compl. ¶ 42.)

Under pressure to meet Golub's publicly announced earnings goals, AEFA allegedly under-priced its insurance products to undercut competitors. (Amended Compl. ¶ 42.) To maintain profitability, AEFA relied increasingly on high-yield, high-risk instruments such as below-investment-grade, or "junk," bonds and collateralized debt obligations ("CDOs").[2] (Amended Compl. ¶¶ 47, 51.) In contrast to the typical insurance industry portfolio, where high-yield investments comprise approximately 7 percent of the total value, AEFA's high-yield holdings constituted approximately 10 to 12 percent of its portfolio. (Amended Compl. ¶ 46.)

Plaintiffs assert that because AEFA's portfolio was heavily reliant on high-yield investments, it was exposed to volatility in the equity markets. (Amended Compl. ¶ 51.) Accordingly, plaintiffs contend that it was imperative for AEFA to monitor its investments to obtain accurate valuations for its holdings and gauge its risk exposure. (Amended Compl. ¶ 52.) Plaintiffs allege that AEFA did not monitor and evaluate the

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[2] CDOs are collections of bonds that are divided into various risk groups and then sold as securities. See ENCYCLOPEDIA OF BANKING & FINANCE 219 (10th ed. 1995). Junk bonds are bonds with a credit rating of BB or lower by rating agencies. They are issued by companies without long track records of sales and earnings or by those with dubious credit strength. See DICTIONARY OF FINANCE AND INVESTMENT TERMS 364 (6th ed. 2003). Unlike investment-grade bonds, junk bonds are dependent on the strength of the equity markets. (Amended Compl. ¶ 51.)

extent of its exposure during the class period because it failed to take steps to obtain reliable information about its investments and the state of the market. (Amended Compl. ¶¶ 52, 54, 59-65.) For example, AEFA allegedly valued certain of its high-yield holdings based on estimates that brokers, who simply act as agents for issuers, assigned to those securities. (Amended Compl. ¶¶ 59-60.) Because AEFA did not employ reliable methods for valuing and overseeing its holdings, plaintiffs claim that it could not monitor the risk in its portfolio. (Amended Compl. ¶¶ 59-65.)

Throughout the class period, AEFA disclosed to investors the amount of money it invested in high-yield instruments. (Amended Compl. ¶ 80.) Nevertheless, plaintiffs allege that various statements by defendants pertaining to the value and extent of AEFA's high-yield investments were materially misleading. Amex's 1998 10-K stated that "[t]he company's objective is to realize returns commensurate with the level of risk assumed while achieving consistent earnings growth." (Amended Compl. ¶ 66.) This statement was repeated in Amex's 10-K for 1999, which was filed with the SEC in March 2000 and signed by defendants Golub, Goeltz, Chenault and Henry. (Amended Compl. ¶ 72.) The 1999 10-K also stated:

> AEFA's owned investment securities are, for the most part, held by its life insurance and investment certificate subsidiaries, which

> primarily invest in long-term and intermediate-term fixed income securities to provide their clients with a competitive rate of return on their investments while minimizing risk. Investment in fixed income securities provides AEFA with a dependable and targeted margin between the interest rate earned on investments and the interest rate credited to clients' accounts. AEFA does not invest in securities to generate trading profits for its own account.

(Amended Compl. ¶ 72.) Amex's 2000 10-K repeated this and similar statements. (Amended Compl. ¶ 73.)

Defendants also issued statements during the class period concerning the internal controls that Amex had in place to monitor its risk exposure. For example, in its 1998 10-K, Amex stated that:

> Management establishes and oversees implementation of Board-approved policies covering the company's funding, investments and use of derivative financial instruments and monitors aggregate risk exposures on an ongoing basis.

(Amended Compl. ¶ 66.) Two years later, defendant Chenault told investors that Amex could weather the economic downturn in 2001 because its "risk management staff are among the best in the business. They are highly skilled and experienced, and have continually improved [Amex's] processes over the years." (Amended Compl. ¶ 140.) Plaintiffs assert that these statements were materially misleading because they misrepresented Amex's high-yield holdings as conservative and because Amex did not

have reliable risk management policies in place during the class period. (Amended Compl. ¶¶ 54-55, 62, 64, 75.)

Beginning in the third quarter of 1999 and continuing through 2000, default rates in the high-yield bond market increased, thus eroding the value of high-yield securities held by AEFA. (Amended Compl. ¶ 76.) Despite these negative developments, Amex did not write down investments in its high-yield portfolio in 1999 or 2000. (Amended Compl. ¶ 102.) Plaintiffs allege, therefore, that Amex's financial statements were false and misleading because they significantly overvalued AEFA's holdings. (Amended Compl. ¶¶ 86, 102.)

Plaintiffs further allege that defendants misled investors by representing that Amex's financial statements were prepared in accordance with generally accepted accounting principles ("GAAP"), which require companies to account for impairments in the value of an investment. (Amended Compl. ¶ 94.) Plaintiffs contend that defendants' statements to this effect were false and misleading because most of AEFA's high-yield investments were valued at amortized cost rather than written down in accord with GAAP. (Amended Complaint ¶¶ 87, 93, 102.)

The Amended Complaint also alleges that defendants' statements concerning Amex's risk management and financial reporting were materially misleading because defendants knew or

recklessly disregarded that Amex's internal controls over the valuation of its high-yield securities were "severely deficient or non-existent." (Amended Compl. ¶ 111.) Plaintiffs claim, additionally, that such statements were materially misleading because defendants knew or recklessly disregarded that Amex continued to hold its investments "in a manner that was contrary to its publicly stated investment philosophy and controls." (Amended Compl. ¶ 111.)

As the equity market downturn deepened, Amex began to disclose the existence of some "deterioration" in its high-yield portfolio. (Amended Compl. ¶ 117.) The Company issued successive statements to this effect in its Form 8-Ks, filed on April 24, 2000, July 24, 2000 and January 26, 2001. (Amended Compl. ¶ 117.) These Form 8-Ks, however, described AEFA's overall asset quality as "strong." (Amended Compl. ¶ 117.)

In a presentation on February 7, 2001, which was later incorporated in a Form 8-K, Chenault acknowledged that the Company had had some problems with its high-yield investments, especially in the fourth quarter of 2000. (Amended Compl. ¶ 136.) During that presentation, Chenault stated that "we have significantly scaled back our activity" in "structured investments, such as collateralized debt obligations." (Amended Compl. ¶ 136.) Chenault also characterized AEFA's "fundamental business model" as "sound." (Amended Compl. ¶ 137.) Plaintiffs

claim that Chenault's statements were materially false and misleading because AEFA's practice of under-pricing IDS insurance policies and making up the difference with high-yield investments, which AEFA failed to monitor adequately, bore significant risk and was fundamentally unsound. (Amended Compl. ¶ 137.)

Two months after Chenault's February 7 presentation, Amex announced that it would take a write-down of $185 million in losses on its high-yield portfolio for the first quarter of 2001 in addition to a $123 million loss realized on its high-yield investments for 2000. (Amended Compl. ¶ 144.) On April 2, 2001, Amex issued a press release announcing that its earnings for the first quarter of 2001 would decrease by 18 percent from its 2000 earnings period. (Amended Compl. ¶ 144.) Amex attributed this decline to a "pre-tax loss of about $185 million from the write-down and sale of certain high-yield securities held in the investment portfolio of its subsidiary [AEFA]." (Amended Compl. ¶ 144.) The press release also stated that "[t]otal losses on these investments for the remainder of 2001 are expected to be substantially lower than in the first quarter." (Amended Compl. ¶ 144.) These losses caused Amex to revise an earlier prediction that it would meet its earnings targets for 2001. (Amended Compl. ¶ 145.) News of this write-down resulted in a 3.8 percent drop in Amex's share price,

representing $2 billion in market capitalization. (Amended Compl. ¶ 147.)

In the wake of this announcement, several of the Individual Defendants made statements that these losses were expected to be lower for the remainder of 2001 than they had been in the first quarter. (Amended Compl. ¶¶ 148-50.) Plaintiffs claim that these statements implied that the problems underlying those losses were sudden, when in fact they had roots as far back as 1999. (Amended Compl. ¶ 148.) Chenault, for example, stated "our analysis of the portfolio at the end of the first quarter did not fully comprehend the risk underlying these structured investments during a period of persistently high default rates." (Affidavit of Robert E. Zimet, dated February 14, 2003 ("Zimet Aff."), Ex. D at 2.)[3] Plaintiffs claim that such statements were false and misleading because: (1) AEFA

[3] Defendants have submitted various exhibits in support of their motion to dismiss, which this Court may consider because they are referenced in the Amended Complaint. See San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801, 808-09 (2d Cir. 1996) (permitting consideration on motion to dismiss of full text of documents partially quoted in complaint); Cortec Indus. v. Sum Holding L.P., 949 F.2d 42, 48 (2d Cir. 1991) (court may consider documents of which plaintiffs have "undisputed notice" and are "integral" to plaintiff's claim); In re Merrill Lynch & Co., Inc., 273 F. Supp. 2d 351, 356-57 (S.D.N.Y. 2003) (same). Further, "[o]n any motion to dismiss based upon [the safe harbor provision for forward-looking statements under the Private Securities Litigation Reform Act ("PSLRA")], the court shall consider any statement cited in the complaint and any cautionary statement accompanying the forward-looking statement, which are not subject to material dispute, cited by the defendant." 15 U.S.C. § 78u-5(e).

still remained exposed to risks from its high-yield holdings; and (2) the deterioration in the value of high-yield investments began in 1999, when default rates surged, not 2001. (Amended Compl. ¶ 151.)

On July 18, 2001, Amex issued a press release announcing that its earnings for the second quarter of 2001 would likely decline 76 percent from the prior year, partly due to an $826 million pre-tax charge to recognize "additional write-downs in the high-yield portfolio at [AEFA] and losses associated with rebalancing the portfolio towards lower-risk securities." (Amended Compl. ¶ 156.)

Chenault subsequently announced that Amex would be scaling back its high-yield assets to 7 percent of its portfolio. (Amended Compl. ¶ 162.) Amex also announced that it was revising its risk control policies by creating a centralized committee to supplement the risk management capabilities of each of its business segments. (Amended Compl. ¶ 172.) Plaintiffs filed this action on July 17, 2002 and amended it on December 10, 2002. (Defendants' Memorandum of Law in Support of Their Motion to Dismiss the Complaint ("Defs. Mem.") at 19.)

DISCUSSION

I. Section 10(b) and Standards for A Motion to Dismiss

On a motion to dismiss, a court must accept the material facts alleged in the complaint as true and construe all reasonable inferences in a plaintiff's favor. Grandon v. Merrill Lynch & Co., 147 F.3d 184, 188 (2d Cir. 1998). A court should not dismiss a complaint for failure to state a claim unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." Conley v. Gibson, 355 U.S. 41, 45-46 (1957). In this limited task, the issue is not whether a plaintiff will ultimately prevail on his claim, but whether the plaintiff is entitled to offer evidence in support of allegations in the complaint. Hamilton Chapter of Alpha Delta Phi, Inc. v. Hamilton Coll., 128 F.3d 59, 62 (2d Cir. 1997).

"To state a cause of action under section 10(b) and Rule 10b-5, a plaintiff must plead that the defendant made a false statement or omitted a material fact, with scienter, and that plaintiff's reliance on defendant's action caused plaintiff injury." San Leandro, 75 F.3d at 808. Proof of reckless conduct satisfies the requirement of scienter in a section 10(b) claim. Glickman v. Alexander & Alexander Servs., Inc., No. 93 Civ. 7594 (LAP), 1996 WL 88570, at *3 (S.D.N.Y. Feb. 29, 1996).

A complaint alleging securities fraud under section 10(b) must satisfy the heightened pleading requirements of Rule 9(b) of the Federal Rules of Civil Procedure and the PSLRA. Kalint v. Eichler, 264 F.3d 131, 138 (2d Cir. 2001). Under Rule 9(b), the circumstances constituting fraud must be stated with particularity, meaning that such allegations must "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." Novak v. Kasaks, 216 F.3d 300, 306 (2d Cir. 2000) (internal quotations omitted). The PSLRA similarly requires that "the complaint shall specify each statement alleged to have been misleading [and] the reason or reasons why the statement is misleading." 15 U.S.C. § 78u-4(b)(1).

Additionally, under the PSLRA, if allegations concerning fraud are made on information and belief, "the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1). Moreover, the PSLRA's scienter provision provides that "the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong

inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2).[4]

Plaintiffs can satisfy this requirement either by alleging facts showing that defendants had both the motive and opportunity to commit fraud, or by alleging facts constituting strong circumstantial evidence of conscious misbehavior or recklessness. Kalint, 264 F.3d at 138 (recklessness is "conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it."). More specifically, plaintiffs can raise a strong inference of fraudulent intent by pleading that the defendant: (1) benefited in a "concrete and personal way" from the alleged fraud; (2) engaged in "deliberately illegal" behavior; (3) "knew facts or had access to information suggesting that their public statements were not accurate"; or (4) failed to verify information that they had a duty to monitor. Novak, 216 F.3d at 311.

[4] The PSLRA did not alter the pleading standard for scienter in this Circuit. Novak, 216 F.3d at 310.

II. Statute of Limitations

A. Notice

As a threshold matter, defendants contend that plaintiffs' claims are time-barred under the Exchange Act's one-year statue of limitations because the initial complaint in this action was filed more than a year after plaintiffs should have been on notice of the alleged fraud. Defendants' argument is unavailing.

Section 10(b) provides that "[n]o action shall be maintained . . . under this section, unless brought within one year after the discovery of facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e) (2000). The one-year limitations period begins to run after the plaintiff "obtains actual knowledge of the facts giving rise to the action or notice of the facts, which in the exercise of reasonable diligence, would have led to actual knowledge." LC Capital Partners LP v. Frontier Ins. Group, Inc., 318 F.3d 148, 154 (2d Cir. 2003) (internal quotations omitted). Such a duty of inquiry arises when circumstances would suggest to a reasonable investor of ordinary intelligence the probability that he has been defrauded. Dodds v. Cigna Secs., Inc., 12 F.3d 346, 350 (2d Cir. 1993). These circumstances are commonly referred to as "storm warnings." Dodds, 12 F.3d at 350. However, to trigger a plaintiff's duty of inquiry, the fraud

indicated by the storm warnings must be probable, not merely possible. Newman v. Warnaco Group, Inc., 335 F.3d 187, 193 (2d Cir. 2003) ("Inquiry notice exists only when uncontroverted evidence irrefutably demonstrates when plaintiff . . . should have discovered the fraudulent conduct.").

The storm warnings on which defendants rely were insufficient to put plaintiffs on inquiry notice of the alleged fraud as a matter of law. Compare, e.g., LC Capital, 318 F.3d at 155 ("a series of three charges in substantial and increasing amounts for the same purpose within four years" sufficient to put plaintiffs on inquiry notice of possible fraud); de la Fuente v. DCI Telecomm., Inc., 206 F.R.D. 369, 382 (S.D.N.Y. 2002) (company restated its financials in two SEC filings and revised its accounting at request of SEC, which ordered a ten-day suspension of trading in defendant's stock); Westinghouse Elec. Corp. v. 21 Int'l Holdings, Inc., 821 F. Supp. 212, 222 (S.D.N.Y. 1993) (numerous analyst reports suggested issuer would be taking large write-downs in amounts similar to announcement that plaintiffs acknowledged had placed them on notice); Norniella v. Kidder Peabody & Co., 752 F. Supp. 624, 628 (S.D.N.Y. 1990) (plaintiff received 169 confirmation slips and 24 monthly statements revealing activity inconsistent with plaintiff's investment objectives), with In re Worldcom, Inc. Secs. Litig., Nos. 02 Civ. 3288 (DLC), 03 Civ. 6592 (DLC), 2003

WL 22738546, at *11-12 (S.D.N.Y. Nov. 21, 2003) (insufficient storm warnings to put plaintiff on inquiry notice "as a matter of law" where defendant took large write down and numerous news stories discussed defendant's accounting problems); Walther v. Maricopa Int'l Inv. Corp., No. 97 Civ. 4816 (HB), 1998 WL 186736, at *4 (S.D.N.Y. Apr. 17, 1998) (6.5 percent decline in principal invested did not amount to storm warning sufficient to put plaintiff on inquiry notice).

While there were harbingers that might have alerted plaintiffs to the possibility of wrongdoing, those signs did not raise a probability of wrongdoing sufficient to put plaintiffs on inquiry notice of fraud. Other than Amex's mention of minimal deterioration in the value of its high-yield holdings in April and July 2000, and January 2001 (Amended Compl. ¶ 117), the sole warning to which defendants can point is the April 2001 write-down.[5] (Amended Compl. ¶¶ 144.)

To conclude that one write-down, albeit significant, put plaintiffs on inquiry notice of defendants' alleged fraud would be inconsistent with the objectives of the PSLRA, which was enacted in large part to discourage premature and frivolous securities fraud suits. See H.R. Conf. Rep. No. 104-369, at 31

[5] The resulting 3.8 percent decline in Amex's share price (Amended Compl. ¶ 147) was significantly less than the 6.5 percent decrease in principal that was held insufficient to constitute a storm warning in Walther. 1998 WL 186736, at *4.

(1995). "[T]he receipt of one bit of bad news, unless earth-shattering, should not function as the equivalent of a shot fired from a starter gun that sets off a mad dash to the courthouse." Walther, 1998 WL 186736, at *4; see also Nivram Corp. v. Harcourt Brace Jonanovich, 840 F. Supp. 243, 252 (S.D.N.Y. 1993) (sharp decline in stock price, standing alone, not dispositive as a storm warning). Accordingly, the warning signs to which defendants point do not "irrefutably" demonstrate that plaintiffs were on inquiry notice one year before plaintiffs commenced this action on July 17, 2002. Newman, 335 F.3d at 193; see also Nivram, 840 F. Supp. at 249 ("defendants bear a heavy burden in establishing that the plaintiff was on inquiry notice as a matter of law").

Applying the developing "storm warnings" jurisprudence of this Circuit to the Amended Complaint, this Court concludes that plaintiffs were on inquiry notice as of July 18, 2001, when: (1) Amex announced a 76 percent decrease in earnings from the previous year owing largely to a write-down in AEFA's high-yield holdings, and stated that it was scaling back its investments in high-yield securities; and (2) Chenault acknowledged that "[Amex] took on securities that didn't have the appropriate balance for [the Company] between risk and reward" (Amended Compl. ¶ 162), after characterizing the Company's risk management capabilities as among the best in the

business (Amended Compl. ¶ 140). The cumulative effect of the April and July 2001 write-downs, coupled with Amex's announcement of the deteriorating value of its high-yield holdings, would have suggested to a reasonable investor of ordinary intelligence the probability of fraud. See Dodds, 12 F.3d at 350; see also Walther, 1998 WL 186736, at *3-4 (sufficiency of storm warnings depends on quantum of information available to plaintiff and time period during which fraud allegedly occurred) (citing cases). Because the initial complaint was filed within one year of the July 18, 2001 announcement, it is not barred by the Exchange Act's statute of limitations.

B. Relation Back

Defendants further argue that even if plaintiffs' initial complaint was timely, the Amended Complaint filed on December 10, 2002, includes new claims that do not relate back to the initial complaint and thus are time-barred. Under Rule 15(c)(2) of the Federal Rules of Civil Procedure, allegations in an amended complaint relate back to the date of the original filing when the amended claim "arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading." Fed. R. Civ. P. 15(c)(2). The main inquiry under this Rule is whether adequate notice of

matters asserted in the amended pleading have been timely given to the opposing party by the general facts alleged in the original pleading. Stevelman v. Alias Research, Inc., 174 F.3d 79, 87 (2d Cir. 1999) ("Where no new cause of action is alleged . . . this Court liberally grants relation back under Rule 15(c)."). However, an amended pleading does not relate back if it introduces a different set of operative facts. Bank Brussels Lambert v. The Chase Manhattan Bank, N.A., No. 93 Civ. 5298 (LMM), 1999 WL 672302, at *2 (S.D.N.Y. Aug. 27, 1999) (allegations relate back only "if the [new] allegations amplify the facts alleged in the original pleading or set forth those facts with greater specificity.").

While the Amended Complaint asserts claims under the same statutes as the initial pleading - sections 10(b) and 20(a) of the Exchange Act - it alleges different facts. The Amended Complaint alleges four primary misrepresentations or omissions of material fact as the foundation for plaintiffs' claims, namely that defendants: (1) misrepresented Amex's high-yield investments as conservative when, in fact, they were high-risk; (2) concealed the extent of Amex's high-yield exposure; (3) failed to disclose the lack of risk management controls; and (4) failed to disclose the lack of proper valuation methods, and the fact that Amex's accounting was not in accordance with GAAP. (Amended Compl. ¶¶ 59-66, 72, 74-75, 86, 102, 111.)

The initial complaint also alleges that Amex misrepresented the risks of its high-yield investments and failed to disclose the extent of its risk exposure, especially in the wake of the April 2001 write-down. (Zimet Aff. Ex. FF: July 17, 2002 Complaint, ¶¶ 1, 16-17, 23.) The initial complaint asserts, for example, that defendants failed "to disclose that American Express had invested in a risky portfolio of high-yield or 'junk' bonds that carried the potential for substantial losses if default rates in the junk bond market increased." (Zimet Aff. Ex. FF ¶ 23.) This allegation is amplified in the Amended Complaint, which claims that defendants portrayed Amex's high-yield investment as safe and thereby misled shareholders about the risks of Company's portfolio. (See, e.g., Amended Compl. ¶¶ 72-73.) The initial complaint also alleges that defendants failed "to disclose the true extent of American Express's total exposure . . . after American Express wrote down $182 million of its junk bond portfolio in April 2001." (Zimet Aff. Ex. FF ¶ 23.) The Amended Complaint expands on this claim and alleges that defendants intentionally downplayed the Company's exposure after the April 2001 write-down. (Amended Compl. ¶ 145 ("defendants continued to understate the extent of the damage [of the April 2001 write-down] by falsely assuring the investing public that '[t]otal losses on these investments for the remainder of 2001 are

expected to be substantially lower than in the first quarter.'").) This Court finds, therefore, that the allegations in the Amended Complaint concerning defendants' failure to disclose the risks of Amex's high-yield investment strategy and its high-yield exposure relate back to the July 17, 2002 complaint.[6] See, e.g., Siegel v. Converters Transp., Inc., 714 F.2d 213, 216 (2d Cir. 1983) (allegations in amended complaint relate back where "gist" of original suit and amended complaint are the same).

In contrast, plaintiffs' allegations in the Amended Complaint that Amex's financial statements were misleading due to improper valuation methods and defendants' statements that the Company's accounting practices accorded with GAAP were false have no such mooring in the initial pleading. Nor does the initial complaint contain allegations that Amex lacked adequate risk controls. The initial complaint simply avers that defendants did not disclose management's failure to "fully comprehend" the risks associated with Amex's high-yield holdings. (Zimet Aff. Ex. FF ¶ 23.) The Amended Complaint, on the other hand, claims that "the procedures for valuing and evaluating AEFA's holdings made it impossible to monitor and gauge risks accurately, and no such risk analysis was taking

[6] These allegations are set forth in Paragraphs 72, 73 and 145 of the Amended Complaint.

place." (Amended Compl. ¶ 74.) These allegations are therefore distinct from those in the initial complaint, as they involve different "operative facts." See Bank Brussels, 1999 WL 672302, at *4-6 (allegations that defendant concealed accounting fraud to induce loan did not relate back to initial allegations that defendant concealed extent of bank fees for same purpose).

Because the allegations in the Amended Complaint concerning Amex's valuation, accounting methods, and risk management controls were not introduced in the initial complaint, defendants did not have adequate notice of these matters within section 10(b)'s one-year statute of limitations. Accordingly, this Court finds that these allegations do not relate back to the initial complaint and are thus time-barred because they fall outside of the one-year statute of limitations, which expired on July 18, 2002.[7]

Defendants further contend that certain documents referenced in the Amended Complaint are time-barred because they were not mentioned in the initial complaint.[8] To support this

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[7] Specifically, the allegations concerning improper valuation methods, which do not relate back, are contained in Paragraphs 52-64, 92-96, 112-19, 180 and 181 of the Amended Complaint. The new claims regarding the lack of risk management procedures, which do not relate back, are set forth in Paragraphs 66, 115, 139-40 and 175 of the Amended Complaint.

[8] These documents include various press releases, 8-K, 10-K and 10-Q reports issued in 2000 and 2001. (Amended Compl. ¶¶ 70, 73, 115, 117, 124-31, 136-37, 148-50, 154.)

argument, defendants rely on In re Bausch & Lomb, Inc. Securities Litigation, which held that a press release referenced solely in the Amended Complaint did not relate back to the original complaint because it "constitute[d] a separate alleged act of fraud." 941 F. Supp. 1352, 1366 (W.D.N.Y. 1996). However, in that case the initial pleading gave no indication that plaintiffs were alleging fraud for the period during which the press release was issued. Bausch & Lomb, Inc., 941 F. Supp. at 1366. Here, by contrast, the documents first mentioned in the Amended Complaint relate primarily to Amex's alleged misstatements concerning the risk of its high-yield holdings and its exposure to these investments after the April 2001 write-down. (See Amended Compl. ¶¶ 70, 73, 115, 117, 124-31, 136-37, 148-50, 154.) Therefore, plaintiffs are not time-barred from relying on the documents referenced in the foregoing paragraphs of the Amended Complaint, as they relate to the same "conduct and transactions" discussed in the initial complaint. See Stevelman, 174 F.3d at 87.

Accordingly, plaintiffs may rely on the press releases, and 8-K, 10-K, and 10-Q reports referenced in Paragraphs 70, 73, 115, 117, 124-31, 136-37, 148-50 and 154 of the Amended Complaint.

III. Defendants' Statements Concerning Amex's Investment Strategy

The Amended Complaint alleges that defendants misrepresented Amex's high-yield portfolio as low risk when precisely the opposite was true. (Amended Compl. ¶¶ 72-75.) Defendants argue that these allegations fail to state a claim for which relief can be granted because defendants disclosed the risks of these investments in an objectively reasonable manner, and plaintiffs merely disagree with defendants' characterization of those risks.

To state a claim under section 10(b) and Rule 10b-5, plaintiffs are required to identify a false statement of material fact or the omission of a material fact. I. Meyer Pincus & Assocs. P.C. v. Oppenheimer & Co., 936 F.2d 759, 761 (2d Cir. 1991); Sheppard v. TCW/DW Term Trust 2000, 938 F. Supp. 171, 174 (S.D.N.Y. 1996). However, where a defendant fully discloses the material facts, plaintiffs cannot predicate a Rule 10b-5 claim on the defendant's failure to disclose those facts in critical terms. See Novak, 216 F.3d at 309 ("as long as the public statements are consistent with reasonably available data, corporate officials need not present an overly gloomy or cautious picture of current performance and future prospects"); Sheppard, 938 F. Supp. at 175 ("Defendants were not obligated to

describe in pejorative terms the types of Mortgage-backed securities in which the Trusts invested.").

The parties agree that defendants fully disclosed the risks of Amex's high-yield investments. (Defs. Mem. at 26-28; Plaintiffs' Memorandum of Law in Opposition to Motion to Dismiss ("Pls. Mem.") at 34.) Indeed, plaintiffs acknowledge that "investors were warned of the risks associated with high-yields." (Pls. Mem. at 34.) Plaintiffs assert, nevertheless, that defendants misrepresented these holdings as conservative by referring to them as "fixed income" investments capable of providing a dependable return. (Amended Compl. ¶ 75.) Having conceded that defendants fully disclosed the risks presented by Amex's high-yield portfolio, plaintiffs' disagreement with defendants' characterization of those risks is insufficient to support a claim under section 10(b). See Sheppard, 938 F. Supp. at 174-75 ("Because . . . the Trusts truthfully represented and adequately disclosed their investment strategies and the inherent risks therein, plaintiffs' claims under [sections 11 and 12 of the Securities Act of 1933 and section 10(b) of the Exchange Act] must be dismissed."). Accordingly, plaintiffs' allegations concerning defendants' disclosures about the risks of Amex's high-yield investments are dismissed.

IV. Statements Concerning Amex's High-Yield Exposure

Defendants argue that their statements regarding Amex's high-yield exposure, including those made after the April 2001 write-down, were forward-looking expressions of opinion accompanied by cautionary warnings, and are therefore protected by the "bespeaks caution" doctrine and the PSLRA safe harbor for forward-looking statements. Pursuant to the judicially-created bespeaks caution doctrine, a forward-looking statement is considered immaterial if accompanied by cautionary language that is sufficiently specific to render reliance on the false or omitted statement unreasonable. In re Nortel Networks Corp. Secs. Litig., 238 F. Supp. 2d 613, 628 (S.D.N.Y. 2003) ("cautionary language 'must precisely address the substance of the specific statement or omission that is challenged'") (internal quotations omitted); Credit Suisse First Boston Corp. v. ARM Fin. Group, Inc., No. 99 Civ. 12046 (WHP), 2001 WL 300733, at *4-5 (S.D.N.Y. Mar. 28, 2001). Under the PSLRA safe harbor, which is modeled on that doctrine, a statement is not actionable if it is "identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." 15 U.S.C. § 78u-5(c)(1)(A); In re GlobalStar Sec. Litig., No. 01 Civ. 1748 (SHS), 2003 WL 22953163, at *8 (S.D.N.Y. Dec. 15,

2003). Such statements, even if unaccompanied by cautionary language, are protected under the PSLRA if a plaintiff fails to allege that they were made with "actual knowledge" that they were false and misleading. In re GlobalStar, 2003 WL 22953163, at *8. However, a statement will not be protected as forward-looking under the PSLRA or the bespeaks caution doctrine if it also includes representations as to current or historical facts. In re Nortel Networks, 238 F. Supp. 2d at 629; Credit Suisse, 2001 WL 300733, at *5.

Defendants contend that Chenault's statements during the February 7, 2001 presentation, which were later filed with the SEC on a Form 8-K, are protected as forward-looking statements. The first such statement, in which Chenault "assured investors that American Express would meet its 12-15% earnings per share targets by year-end" (Amended Compl. ¶ 142), was clearly a projection of earnings within the PSLRA safe harbor. See 15 U.S.C. § 78u-5(i)(1)(A). Moreover, this statement was accompanied by numerous cautionary warnings, including that "[c]ontinued persistency of defaults is likely to have a negative impact on earnings." (See Zimet Aff. Ex. Z at 1-2, 9.) Because the Amended Complaint fails to allege that Chenault knew that this specific projection was false as of February 7, 2001, his statement assuring investors that Amex would meet its earnings targets during the presentation is not

actionable under the PSLRA or bespeaks caution doctrine. See Novak, 216 F.3d at 308 (plaintiffs must specifically allege knowledge of facts contradicting defendant's public pronouncements).[9]

In another statement during the February 2001 presentation, Chenault characterized AEFA's business model as "sound." (Amended Compl. ¶ 137.) This statement described a present fact and thus is not protected by the PSLRA or the bespeaks caution doctrine. Credit Suisse, 2001 WL 300733, at *5. Nevertheless, this statement is not actionable because plaintiffs' bases for claiming that it was misleading are themselves not actionable. Plaintiffs cannot claim that Chenault's characterization was false or misleading owing to the lack of risk management controls because this Court has determined that those allegations are time-barred. (See supra Section II.B.) Plaintiffs also cannot claim this statement to

[9] While plaintiffs can raise an inference of fraudulent intent by alleging specific facts to show that defendants had access to information indicating that their public statements were misleading, Novak, 216 F.3d at 311, plaintiffs cannot establish scienter through defendants' management positions and access to various internal documents alone. See In re Health Mgmt. Sys. Secs. Litig., No. Civ. 1865 (HB), 1998 WL 283286, at *6 (S.D.N.Y. June 1, 1998) ("[C]ourts have routinely rejected the attempt to plead scienter based on allegations that because of defendants' board membership and/or their executive managerial positions, they had access to information concerning the company's adverse financial outlook."); Glickman, 1996 WL 88570, at *14 (inferring scienter based on CEO's access to company records "would expose virtually every CEO, by virtue of his or her position alone, to liability").

be false based on the "questionable" practice of under-pricing IDS insurance policies while investing in high-risk securities because such claims amount merely to allegations of mismanagement, which are not actionable under section 10(b). Santa Fe Indus. v. Green, 430 U.S. 462, 479 (U.S. 1977); accord Ciresi v. Citicorp, 782 F. Supp. 819, 821 (S.D.N.Y. 1991) ("Even if well-pled, allegations of mismanagement are not actionable under section 10(b)."); Lerner v. FNB Rochester Corp., 841 F. Supp. 97, 101 (W.D.N.Y. 1993) (dismissing allegations based on "displeasure with the judgment calls made by management, which turned out to have been poorly made, and with management's failure to anticipate that its portfolio would be particularly vulnerable in an economic slump.").

Similarly, Chenault's statement during the same presentation that "[f]or structured investments, such as [CDOs], we have significantly scaled back our activity" (Zimet Aff. Ex. Z at 8.), is not forward-looking, as it plainly refers to past and current facts. Credit Suisse, 2001 WL 300733, at *5. This statement therefore is not covered by the PSLRA's safe harbor or the bespeaks caution doctrine. Credit Suisse, 2001 WL 300733, at *5.

Amex's statement in the April 2, 2001 press release that losses on high-yield investments for the rest of 2001 were expected to be substantially lower than in the first quarter of

2001 qualifies as a projection. (Amended Compl. ¶ 144.) This statement was accompanied by the warning that "potential deterioration in the high-yield sector . . . could result in further losses." (Zimet Aff. Ex. C at 5.) That warning, however, does not insulate the April 2001 press release under the PSLRA safe harbor or the bespeaks caution doctrine because it was not based on specific facts, and therefore was insufficiently precise. See Credit Suisse, 2001 WL 300733, at *8 ("[W]arnings of specific risks . . . do not shelter defendants from liability if they fail to disclose hard facts critical to appreciating the magnitude of the risks described.").

Finally, Cracchiolo's statements during conference calls on April 2, 2001, in which he assured analysts that problems with Amex's high-yield investments had largely been put to rest (Amended Compl. ¶¶ 148-50) are not protected. Defendants can point to no cautionary language that would bring these statements within the cover of the PSLRA's safe harbor for forward-looking statements or the bespeaks caution doctrine.

Accordingly, Chenault's statements during the February 7, 2001 presentation as described in Paragraphs 137 and 142 of the Amended Complaint are not actionable. However, Chenault's statement concerning Amex's scale-back of its structured investments described in Paragraph 136 of the Amended Complaint

is not protected by the PSLRA safe harbor. Further, Amex's statement that losses for the first quarter of 2001 were expected to be lower than in the first quarter (Amended Compl. ¶ 144) is not protected by the PSLRA or bespeaks caution doctrine and is therefore actionable, as are Cracchiolo's statements during conference calls on April 2, 2001 (Amended Compl. ¶¶ 148-50.)

V. Scienter

Having determined that several of defendants' statements may be actionable,[10] the question arises whether plaintiffs have adequately pled scienter to proceed on those claims. Defendants contend that plaintiffs fail to allege scienter because they have not pleaded facts raising a strong inference of fraudulent intent or that demonstrate motive and opportunity.

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[10] Specifically, these statements include Chenault's February 7, 2001 presentation in which he stated, "we have significantly scaled back our activity" in "structured investments such as [CDOs]." (Amended Compl. ¶ 136.) Also potentially actionable is Amex's press release claiming, "[t]otal losses on these investments for the remainder of 2001 are expected to be substantially lower than in the first quarter." (Amended Compl. ¶ 144.) Finally, Cracchiolo's repetition of Amex's April 2, 2001 press release and his statements that the Company had put significant exposure behind it by scaling back its reliance on high-yield investments, and that the write-down was caused partly by "asbestos problems and fallen angels that were in the better graded areas that came about rather quickly," also may be actionable. (Amended Compl. ¶¶ 148-51.)

To establish scienter, plaintiffs must allege circumstances supporting an inference that defendants knew, or but for recklessness, should have known of specific facts contradicting their public material statements, thereby demonstrating conscious wrongdoing or recklessness. Rombach v. Change, 355 F.3d 164, 177 (2d Cir. 2004); Kalint, 264 F.3d at 138. Plaintiffs can also establish scienter by alleging facts that show both motive and opportunity to commit fraud. Kalint, 264 F.3d at 138. Such facts must be pleaded with particularity. 15 U.S.C. § 78u-4(b)(1). "[A] 'pleading technique [that] couple[s] a factual statement with a conclusory allegation of fraudulent intent' is insufficient to 'support the inference that the defendants acted recklessly or with fraudulent intent.'" Rombach, 355 F.3d at 177 (quoting Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1129 (2d Cir. 1994)).

As to Chenault's February 7, 2001 statement that the Company had significantly scaled back its structured investments such as CDOs, plaintiffs allege that AEFA remained highly exposed to such investments and wrote off $403 million in CDOs in July of that year. (Amended Compl. ¶ 136.) However, plaintiffs have not "specifically alleged [Chenault's] knowledge of facts or access to information contradicting [this] public statement[]" at the time the statement was made. Novak v.

Kasaks, 216 F.3d 300, 308 (2d Cir. 2000).[11] Therefore, plaintiffs have not sufficiently alleged that Chenault acted with conscious misbehavior or recklessness in making this statement. See Kalint, 264 F.3d at 138.

Similarly, plaintiffs have not adequately alleged motive and opportunity for Chenault individually. Sufficient motive allegations involve "concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged." Novak, 216 F.3d at 307. Additionally, plaintiffs "must assert a concrete and personal benefit to the individual defendants resulting from the fraud." Kalint, 264 F.3d at 139. Here, plaintiffs allege that defendants had the motive to inflate Amex's reported profits and the market price of its stock because "Golub's incentive payments were tied to American Express's financial performance." (Amended Compl. ¶¶ 193-94.) These allegations do not sufficiently allege motive because incentive compensation alone has been rejected as a foundation for fraud claims absent a more specific link to the fraud. See Novak, 216 F.3d at 307 (motive to sustain "the appearance of corporate profitability, or . . . the success of an investment" is possessed by all corporate officers and is

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[11] As discussed, plaintiffs cannot impute scienter to Chenault solely by virtue of his position as CEO of the Company. See, e.g., Glickman, 1996 WL 88570, at *14 (inferring scienter based on CEO's access to company records would expose every CEO to liability based on their positions).

thus insufficient); San Leandro, 75 F.3d at 814 (company's desire to maintain high bond or credit rating insufficient motive for fraud); Acito v. IMCERA Group, Inc., 47 F.3d 47, 54 (2d Cir. 1995) (holding insufficient allegations that officers were motivated to inflate value of stock to increase compensation).[12]

As to the remaining statements,[13] plaintiffs "do not allege facts and circumstances that would support an inference that defendants knew of specific facts that are contradictory to their public statements." Rombach, 355 F.3d at 177. First, plaintiffs allege that Amex's statement that losses for the rest of 2001 were expected to be lower than in the first quarter was false because AEFA had adopted an accounting change requiring close examination of its high-yield securities, which had previously been carried at cost. (Amended Compl. ¶ 145.) Plaintiffs further claim that the veracity of Amex's statement

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[12] This is not a case such as Stevelman, where plaintiff adequately pled motive based on allegations that corporate insiders misrepresented facts regarding their company's performance to inflate its stock price while they sold their own shares at a profit. 174 F.3d at 85.

[13] Specifically, Amex's statement, "[t]otal losses on these investments for the remainder of 2001 are expected to be substantially lower than in the first quarter" (Amended Compl. ¶ 144), and Cracchiolo's statements that losses for the rest of 2001 would be less than those in the first quarter, that Amex had put a significant amount of exposure behind it by scaling back its high-yield holdings, and that the write-down was due partly to "asbestos problems and fallen angels that were in better graded areas." (Amended Compl. ¶¶ 148-50.)

is undermined because there was no significant change in the high-yield bond market between April and July 2001, and, therefore, the July write-down was not attributable to any sudden change. (Amended Compl. ¶ 145.) However, these allegations do not demonstrate Amex's fraudulent intent since this Court cannot conclude that defendants foresaw or, but for their recklessness, could have foreseen that losses from AEFA's high-yield holdings would increase in the remainder of 2001 due to continued deterioration of high-yield securities. Pleading fraud by hindsight is impermissible. See Novak, 216 F.3d at 309 ("Allegations that defendants should have anticipated future events . . . do not suffice to make out a claim of securities fraud."); accord Bond Opportunity Fund v. Unilab. Corp., No. 99 Civ. 11704 (JSM), 2003 WL 21058251, at *10 (S.D.N.Y. May 9, 2003). The PSLRA was not intended to punish defendants for their lack of Delphic clairvoyance.[14]

Plaintiffs' conclusory allegation that "AEFA was aware that the portfolio was still unbalanced and overvalued due to junk bonds and risky CDOs" (Compl. ¶ 145) cannot establish scienter on the part of Amex. See Rombach, 355 F.3d at 177 ("a 'pleading technique [that] couple[s] a factual statement with a

[14] Plaintiffs' allegation concerning Cracchiolo's statement that losses for the duration of 2001 would be less than in the first quarter of that year (Amended Compl. ¶¶ 148, 151) is not actionable for the same reasons.

conclusory allegation of fraudulent intent' is insufficient to 'support the inference that the defendants acted recklessly or with fraudulent intent.'") (quoting Shields, 25 F.3d at 1129). Accordingly, plaintiffs have not adequately pled scienter as to Amex's statement in Paragraph 145 of the Amended Complaint.

Finally, plaintiffs assert that Cracchiolo's statement regarding "asbestos problems and fallen angels" falsely implied that the problems underlying Amex's April 2001 write-down were new and unexpected. (Amended Compl. ¶ 149.) Additionally, plaintiffs allege that Cracchiolo's statement that Amex had put a significant amount of exposure behind it by reducing its reliance on high-risk structured investments was false because "defendants knew or recklessly disregarded" that "AEFA remained exposed to CDOs." (Amended Compl. ¶ 151.) However, these allegations are based on plaintiffs' interpretations of Cracchiolo's statements. The securities laws do not afford relief based on the implications of statements that plaintiffs claim are misleading. Rule 9(b) and the PSLRA entail consideration of the statements that a plaintiff contends were false, not plaintiff's interpretations of those statements. See Fed R. Civ. P. 9(b); 15 U.S.C. § 78u-4(b)(1)[15]; see also San

[15] Under Rule 9(b), plaintiffs must "explain why the statements were fraudulent." Novak, 216 F.3d at 306 (emphasis added). The PSLRA likewise requires that "the complaint shall specify each statement alleged to have been misleading [and] the

Leandro, 75 F.3d at 813 ("Since plaintiffs have not alleged circumstances indicating that any of the statements identified in the Complaint were false, the plaintiffs have failed to adequately plead fraud."); In re Merrill Lynch, 273 F. Supp. 2d at 358 ("[T]he federal securities laws at issue here only fault those who, with intent to defraud, make a material misrepresentation or omission of fact."). Accordingly, plaintiffs have not adequately pleaded that Cracchiolo acted with fraudulent intent in making the statements described in Paragraphs 148 through 150 of the Amended Complaint.

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reason or reasons why the statement is misleading." 15 U.S.C. § 78u-4(b)(1) (emphasis added).

CONCLUSION

For the foregoing reasons, defendants' motion to dismiss the Amended Complaint is granted as to all defendants with leave to replead scienter as to defendants' statements in Paragraphs 136, 144, and 148-50 of the Amended Complaint.[16]

Dated: March 31, 2004
New York, New York

SO ORDERED:

WILLIAM H. PAULEY III
U.S.D.J.

[16] Since plaintiffs have not adequately pleaded violations of Section 10(b) and Rule 10b-5, plaintiffs' claims under Section 20(a) of the Exchange Act also are dismissed. See Feasby v. Industri-Matematik Intern. Corp., No. 99 Civ. 8761 (HB), 2000 WL 977673, at *7 (S.D.N.Y. Jul. 17, 2000) ("Because plaintiffs have failed to adequately plead a primary violation under Section 10(b), their Section 20(a) claim for 'controlling person' liability must likewise be dismissed.").

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